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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

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EX PARTE

November 20, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. - Room 222
Washington, DC 20554

RE: Ex Parte Notice - CC Docket No 96-150

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Mr. Mr. Caton;

On November 20, 1996, Mike Crumling, Jim Deignan, Lyn Rogers-Haney, Sherry Herauf, Kathleen Larkin and Porter Childers representing the United States Telephone Association (USTA) met with Ken Moran, Warren Firschein, John Giusti and Andy Mulitz of the Federal Communications Commission's Common Carrier Bureau, to discuss USTA's position regarding the issues in the CC Docket No. 96-150 proceeding. The attached material was the basis for the presentation and discussion.

The discussion was consistent with USTA's comments and reply comments on file in this proceeding.

In accordance with Section 1.1206(a)(1) of the Commission's rules, two copies of this notice are being submitted to the Secretary of the FCC today. Please include it in the public record of this proceeding.

Respectfully submitted,

A handwritten signature in cursive script that reads "Porter E. Childers".

Porter E. Childers
Executive Director-Legal and Regulatory Affairs

Attachment

cc: Ken Moran
Warren Firschein
John Giusti
Andy Mulitz

No. of Copies rec'd 241
List A B C D E

USTA
CC DOCKET NO. 96-150

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FEDERAL COMMUNICATIONS COMMISSION
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ACCOUNTING SAFEGUARDS UNDER THE
TELECOMMUNICATIONS ACT OF 1996

ESTIMATED FAIR MARKET VALUATION IS NOT AN APPROPRIATE VALUATION METHOD

- Estimated Fair Market Valuation (EFMV) Is a Subjective Valuation Process
- EFMV Has Less of an Audit Trail Than The Verifiable FDC and Prevailing Price Valuations
- The Proposed EFMV Test Does Not Meet the Commission's Heavy Burden Test For A Rule Change

**ESTIMATED FAIR MARKET VALUATION
CONFLICTS WITH SECTION 272
NONDISCRIMINATION REQUIREMENTS**

- **Based Upon Section 272(e)(2) Nondiscrimination Requirements, EFMV Could Impose Higher Prices to Third Parties**

ESTIMATED FAIR MARKET VALUATION CANNOT PROPERLY VALUE AFFILIATE SERVICES

- Affiliate Services Are Generally Highly Technical and Company Specific In Nature And Involve Proprietary And Sensitive Business Information
- Many Affiliate Services Would Not Be Generally Available On The Open Market And Would Not Be Services A Business Would Outsource. Examples: Security, Investor Relations, Corporate Planning

THE CURRENT ACCOUNTING SAFEGUARDS HAVE THE APPROPRIATE FOCUS

- The Current Accounting Rules Provide More Than Adequate Protections Against Cross-Subsidy
- The Proper Focus Of Accounting Safeguards Is Cross Subsidy - Not Nondiscrimination
- The Current Accounting Rules Recognize The Benefit Of The Economies Of Scope And Scale To The Ratepayer

THE CURRENT ACCOUNTING SAFEGUARDS' USE OF PREVAILING PRICE SHOULD BE RETAINED

- Prevailing Price Is More Auditable Than The Subjective EFMV
- Prevailing Price Is Established By The Market - A Willing Buyer Purchasing From A Willing Seller
- Prevailing Price Is Consistent With The Intent Of Section 272, Particularly 272(e)(2)

PROPOSED ORDER LANGUAGE FOR SECTION 272(d) AUDIT REQUIREMENTS

- **SCOPE OF AUDIT:** The purpose of this audit is to determine compliance with the 1996 Telecommunications Act Section 272 separate affiliate requirements for the manufacturing and in-region interLATA affiliates prescribed under this section, particularly the separate accounting requirements under subsection 272(b). Where such requirements are codified within FCC regulations, the audit standard is compliance with those regulations. Where such requirements are inherent in the Act, the audit standard is compliance with requirements of the Act as written in Section 272.
- **SUBMISSION OF AUDIT RESULTS TO THE FCC AND STATE COMMISSIONS - SECTION 272(d)(2):**
 - » The audit report should be in the format and contain information as prescribed by the AICPA audit standards. These standards are the basis upon which independent audit firms routinely perform a compliance audit and are also consistent with the requirements of the Act to obtain an independent audit firm (Section 272(d)(1)).
 - » The audit report will be submitted to the FCC and to each in-region state Commission for which the BOC and the in-region Section 272 affiliates provide service.
 - » The Commissions to which the report is submitted shall make such audit report available for public inspection. Any party may submit comments on the final audit report.

PROPOSED ORDER LANGUAGE FOR SECTION 272(d) AUDIT REQUIREMENTS

- ACCESS TO DOCUMENTS - SECTION 272(d)(3)
 - » The independent auditor shall have access to the financial accounts and records of each company and its affiliates necessary to verify transactions conducted with that company that are relevant to the specific activities permitted under this section for the independent audit.
 - » FCC and State Commissions that receive an audit report have access to the working papers and supporting material of the independent auditor who performs an audit under this section; and the State Commissions shall implement appropriate procedures to ensure the protection of any proprietary information submitted to it under this section, with those state proprietary standards being no less protective than the FCC proprietary information requirements.
 - » Public access is solely to the final audit report.
- INDEPENDENT AUDITOR ENGAGEMENT - SECTION 272(d)(1):
 - » The engagement letter is a contract between the BOC and the BOC's selected external independent auditor.
 - » The engagement letter will contain the scope of the independent audit as previously described.

SECTION 272 COMPLIANCE ISSUES

- **STRUCTURAL AND TRANSACTIONAL REQUIREMENTS (Section 272(b) FOR THE SECTION 272(a) SEPARATE AFFILIATE)**
 - A. Confirm compliance with the requirement that the separate affiliate maintains books, records, and accounts that are separate from the books, records, and accounts maintained by the BOC of which it is an affiliate, and are maintained in accordance with GAAP.
 - B. Confirm compliance with the requirement that the separate affiliate has not obtained credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the BOC.
 - C. Confirm compliance with the requirements that all transactions with the BOC of which it is an affiliate are on an arm's length basis, with any such transaction reduced to writing and available to public inspection.
 - D. Confirm that the separate affiliate operates independently from the BOC
 - E. Confirm that the separate affiliate has separate officers, directors, and employees from the BOC of which it is an affiliate

SECTION 272 COMPLIANCE ISSUES

- **BOC NONDISCRIMINATION SAFEGUARD REQUIREMENTS FROM SECTIONS 272(c)**
 - A. Confirm compliance with the requirement that the BOC accounts for all transactions with an affiliate required by 272(a) in accordance with the accounting principles designated or approved by the FCC**
 - B. Confirm compliance with the requirement that the BOC may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards.**

SECTION 272 COMPLIANCE ISSUES

- SECTION 272(e) - CONFIRM THAT A BOC AND AN AFFILIATE SUBJECT TO REQUIREMENTS OF SECTION 251(c):
 - A. Fulfilled any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provided such telephone exchange service and exchange access to itself or to its affiliates
 - B. Did not provide any facilities, services, or information concerning its provision of exchange access to the affiliate in 272(a) unless such facilities, services, or information were made available to other providers of interLATA services in that market on the same terms and conditions.
 - C. Charged the affiliate described in 272(a), or imputed to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that was no less than the amount charged to any unaffiliated interexchange carriers for such service
 - D. Did not provide any interLATA or intraLATA facilities or services to its interLATA affiliate unless such services or facilities were made available to all carriers at the same rates and on the same terms and conditions, so long as the costs were appropriately allocated

SECTION 272 COMPLIANCE ISSUES

- SECTION 272(g) JOINT MARKETING

A. Confirm compliance that the BOC may not market or sell interLATA service provided by an affiliate required by Section 272 within any of its in-region States until such company is authorized to provide interLATA services in such state under Section 271(d)

B. A BOC affiliate required by this section may not market or sell telephone exchange services provided by the BOC unless that company permits other entities offering the same or similar service to market and sell its telephone exchange services.

[Note: Per Section 272(g)(3) "The joint marketing and sale of services permitted under this subsection shall not be considered to violate the nondiscrimination provisions of subsection (c)"]

THE SECTION 272 AUDIT REQUIREMENTS ARE CLEARLY DEFINED IN THE ACT - THE NARUC PROPOSALS GO WELL BEYOND THAT DEFINITION

- CONTRARY TO NARUC'S EXPANSION OF THE INTENT TO THE ACT:
 - » The scope of the audit is defined by the ACT and is limited to the requirements defined in the Act
 - » The selection of an independent audit firm is the sole responsibility of the BOC as defined in Section 272(d)(1) "A company required to operate a separate affiliate under this section shall obtain and pay for . . ."
 - » The Act DOES NOT require that the BOC issue a Request for Proposal for the engagement of an independent auditor
 - » The Act requires that an independent audit firm, not Commission auditors, conduct the biennial audit. The Commission staffs should not be involved in the day to day operation of the audit. Further, interim reporting is not part of the independent audit process. The goal is to produce a final audit report with appropriate workpapers for review by the Commissions and their staffs. There is no need for a costly and duplicative FCC/State permanent audit staff to manage or coordinate the work the independent auditor is required to do by the Act

**THE SECTION 272 AUDIT REQUIREMENTS ARE CLEARLY DEFINED
IN THE ACT - THE NARUC PROPOSALS GO WELL BEYOND THAT
DEFINITION**

- » USTA generally agrees with the comments of NARUC regarding how Commissions will gain access to the independent auditor's workpapers. However, it should be noted that:
 - Workpapers belong to and are the custody of the independent auditor;
 - Proprietary issues should be addressed as the FCC adopts in its pending order in GC Docket No. 96-55
- » The biennial audit should begin 2 years after Section 271 authorization
- » When the separate affiliate requirements in Section 272 sunset, the audit requirement sunsets per 272(f)

